85-1633

No.———

SUPREME COURT, U.S.
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In The

# Supreme Court of the United States

October Term, 1985

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MERCHANTS NATIONAL BANK OF MOBILE,

*Cross-Petitioner,*

vs.

UNITED STATES OF AMERICA,

*Cross-Respondent.*

———o———

## CROSS-PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

———o———

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## QUESTIONS PRESENTED

The questions presented are:

I. Whether the government is precluded from asserting the tax claim herein under the compulsory counterclaim rule of the Claims Court since the same parties and transactions were in issue in a prior Congressional Reference case.

II. Whether it was tantamount to an abuse of discretion for the lower courts to fail to render a Rule 56(b) judgment on the § 3505(a) claim based on facts admitted by the government which are consistent with IRS regulations.

III. Whether the § 3505(b) action is precluded under Rule 56(b) by uncontradicted government admissions that the loans in issue were ordinary working capital loans.

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UNITED STATES OF AMERICA,

*Cross-Respondent.*

## CROSS-PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Cross-Petitioner, Merchants National Bank of Mobile, cross-petitions for writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

## OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-4a) is reported at 772 F.2d 1522. The opinion of the dis-

trict court (App., *infra,* 5a-9a) is reported at 54 AFTR 2d 84-5752.

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## JURISDICTION

The judgment of the court of appeals (App., *infra,* 10a-11a) was entered on October 7, 1985. On December 16, 1985, Justice Powell extended the time within which Cross-Respondent could file a petition for writ of certiorari to, and included, March 6, 1986. Cross-Respondent filed its petition for writ of certiorari on that date, No. 85-1480. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The cross-petition for writ of certiorari is filed under Supreme Court Rule 19.5, the petition for writ of certiorari having been received by Cross-Petitioner on March 10, 1986.

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## STATUTE INVOLVED

Section 3505 of the Internal Revenue Code of 1954 (26 U.S.C.) is set out in the statutory appendix (App., *infra,* 13a-14a).

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## STATEMENT

On March 18, 1983, the United States brought this action in the United States District Court for the Southern District of Alabama against The Merchants National Bank of Mobile,[1] a bank with its principal place of business in Mobile, Alabama (hereinafter "MNB"). The complaint alleged that MNB had lent funds to Dri-Mix Products, Inc. (hereinafter "Dri-Mix") under circumstances that rendered MNB personally liable under §§ 3505(a) and (b).[2]

MNB answered, asserting as affirmative defenses that the government was precluded from bringing this suit because it was a compulsory counterclaim to litigation between the parties in the United States Claims Court, that specific IRS regulations declared MNB not liable for the unpaid taxes under § 3505(a), and that all funds supplied by MNB were ordinary working capital loans which are excluded from the purview of § 3505. (R.V.1.,p.7). After discovery, MNB sought summary judgment on each of these affirmative defenses.

The District Court denied MNB's first motion for summary judgment, and the Court of Appeals affirmed. However, the Appellate Court did not consider the issues because it mistakenly concluded that MNB had "all but conceded at oral argument" that the cross-appeal was "without merit." (App., p.3a). MNB had no occasion

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[1]Subsequent to the filing of the complaint in this matter, MNB was merged into, and is now known as, First Alabama Bank.

[2]Unless otherwise noted, all references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended.

to take exception to the comments of the Eleventh Circuit since it nonetheless affirmed the District Court's judgment granting a second motion for summary judgment filed by MNB on the notice issue made the basis of the government's petition for writ of certiorari. In fact, MNB only responded with candor at oral argument that it would not have cross-appealed the denial of its first summary judgment motion had the government not appealed on the § 6303(a) notice issue.

The relevant uncontradicted facts necessary to this cross-petition for writ of certiorari are as follows:

Dri-Mix had been a customer of MNB for approximately six (6) years before the events leading to the government's claim herein. During this period Dri-Mix solicited and was awarded several government contracts, which were financed by MNB without default by Dri-Mix. (Supplemental Record, Deposition of Richard Kanehl, pages 7-10 [hereinafter "Deponent,p.—"]).

On December 27, 1976, MNB and Dri-Mix entered into a standard data processing service contract under which MNB agreed to provide its standard payroll service as set forth in the manual attached to said contract. (Browning, pp.10,32; Exhibits 1,2). Pursuant thereto, MNB prepared payroll checks and earnings statements for Dri-Mix's employees from data supplied by Dri-Mix. (Browning, pp. 43-44; R.V.1,p.91). At no time did MNB undertake the responsibility for withholding and remitting taxes or delivering payroll checks to employees.

Also in late 1976, Dri-Mix solicited and was awarded a large government contract for the assembly of "C-rations." This required Dri-Mix to obtain loans for addition-

al working capital which were much more than MNB's internal lending limit to Dri-Mix. (Patrick,p.36-37). At the behest of Dri-Mix, MNB forwarded to the Federal Reserve Bank of Atlanta, on January 19, 1977 an application and supporting documents requesting an eighty-five percent (85%) loan guarantee under the Defense Production Act of 1950 as amended by Executive Order No. 10480 and Regulation V (hereinafter "V-loan I").

The V-loan I application was forwarded to the Defense Logistics Agency (hereinafter "DLA") and approved. On April 5, 1977 a federally approved form of loan agreement was executed between MNB and Dri-Mix covering a $1.4 million loan, and on that same date the government issued its guarantee to MNB of the repayment of 85% of said loan. (Tovar,p.6-11,14; Exhibits 1,2). The loan agreement provides that "Borrower will use the proceeds of advances on the loan *solely to provide or replenish working capital* in connection with or on account of those contracts listed" in the loan agreement. (Tovar, p.14; Exhibit 2). The borrowed funds were never used for any other purpose.

Unknown to MNB, DLA decided in early July, 1977 that its V-loan guarantee, upon which MNB had relied in extending credit to Dri-Mix, was invalid. On July 20, 1977, government employees of DLA visited MNB and informed Dri-Mix and MNB that the V-loan guarantee was invalid due to the DLA's failure to understand the circumstances under which it could issue such a guarantee. At this time MNB had made loans to Dri-Mix totaling approximately $1.9 million, well in excess of its lending limit, on the strength of the V-loan guarantee. DLA offered to cure

the technical problems so that the original purposes of the loan could be completed and requested that MNB continue financing Dri-Mix pending resolution of the V-loan guarantee because of the *urgent* need for C-rations at the time. (Tovar,pp.25,35). MNB continued to provide working capital through December 9, 1977, the date of the second V-loan (hereinafter "V-loan II"). (Tovar,p.36).

Prior to July 20, 1977, Dri-Mix had always deposited and paid its federal withholding taxes, and MNB had no knowledge or information that Dri-Mix had not always timely done so. Both on and after July 20, 1977, MNB continued to honor its payroll service contract with Dri-Mix, and it continued to provide working capital loans on the basis of the governments "urgent needs" and the strength of its assurances that the V-loan guarantee would be revitalized. Working capital loans were supplied in the form of overdrafts to the Dri-Mix regular checking account pending the government's assured revitalization of the V-loan guarantee. (Patrick,p.75). The borrowed funds were never used for any purpose but as working capital.

Unknown to MNB, Dri-Mix failed to pay its withholding taxes for the period from July 20, 1977 through the third quarter of 1977. (Patrick,p.84). Dri-Mix's own president testified without refutation that even he did not know that the taxes had not been paid until an IRS Agent visited him in October, 1977. (Kanehl,pp.32-33).

On that visit, October 3, 1977, the IRS agent requested from Dri-Mix and was given information as to Dri-Mix's lender, MNB, its outstanding loans and financial dealings. The agent instructed Dri-Mix to resume deposits of with-

holding taxes, and Dri-Mix did so, through working capital loans and overdrafts from MNB, all during the fourth quarter of 1977 until December 9, 1977. (Andreades,p.12; Exhibit 1). On November 9, 1977, unknown to MNB, the government assessed taxes unpaid by Dri-Mix for the third quarter of 1977 in the amount of $211,881.52. (R.V.1,p.2).

On December 9, 1977, DLA, MNB and Dri-Mix entered into V-loan II. The loan agreement was prepared by DLA with knowledge that Dri-Mix had not remitted withholding taxes for the third quarter of 1977, and specifically recognizes that the funds supplied by MNB during the interim period from July 20, 1977 to December 9, 1977 were used as ordinary working capital, and that Dri-Mix was applying for *further* working capital or to *replenish* its working capital. (Tovar,pp.36-58; Exhibits 14,15).

Significantly, the loan agreement prohibited the payment of the past due taxes to the Internal Revenue Service from this working capital loan unless it was agreed to by the administrative contracting officer (ACO). Payment of the taxes was never permitted by the government. (Tovar,pp.62,73).

On or about February 6, 1978, Dri-Mix filed for reorganization under the Bankruptcy Act and was later liquidated. On May 15, 1978, the government assessed taxes unpaid by Dri-Mix for the fourth quarter of 1977. (R.V.1, p.2). Again, notice of that assessment was not given to MNB.

On December 24, 1980, MNB filed an action against the government in the United States Court of Claims.[3]

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[3]This action was filed pursuant to S. Res. 291, 96th Congress, Second Session, referring S. 2050, a bill for the relief of MNB to the Chief Commissioner of the United States Claims Court, who assigned the matter Congressional Reference No. 1-80 and docketed same on October 1, 1980.

The petition therein alleges in part:

> During the time from the cancellation of the first V-loan guarantee to the execution of the replacement and V-loan Guarantee, the Bank was supporting Dri-Mix as much as possible, given the Bank's capabilities and Dri-Mix's production circumstances.
>
> * * *
>
> As a direct and proximate result of DLA's arbitrary, capricious, and unreasonable actions in cancelling the V-loan Guarantee (regarding which the Bank had relied on DLA and its fiscal agent to its detriment), in not providing its full support and assistance as represented in obtaining a full replacement V-Loan Guarantee, and in improperly requiring and demanding that an unguaranteed revolving line of credit be instituted as a prerequisite to the issuance of V-Loan Guarantee DLA-CFF-VL-2-77, the Bank has suffered substantial unrecovered losses, including the loss of monies which would have not been continuously extended by the Bank but for DLA's first V-Loan Guarantee and offer of full support and assistance for the replacement Guarantee.

(R.V.2,pp.317-331).

The government answered, but claimed no right of setoff or other counterclaim for tax liability of MNB arising out of these very same loan transactions. The case was tried before the Honorable Judge Louis Spector beginning on October 12, 1982 and the record was closed on or about February 22, 1983. Judge Spector rendered an opinion in favor of MNB for MNB's losses and liabilities during the third and fourth quarters of 1977 on April 30, 1984. *See Merchants National Bank of Mobile v. United States,* 5 Cl. Ct. 180 (1984). The Review Panel affirmed that decision on December 6, 1984, *Merchants National Bank of Mobile v. United States,* 7 Cl. Ct. 1 (1984), and

the matter was returned to Congress for action, where it is still pending.

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## REASONS FOR GRANTING THE CROSS-PETITION

The court of appeals has decided important questions concerning federal rules of civil procedure and federal tax law in a manner which conflicts with decisions of the United States Claims Court and the Legislative History of § 3505. This Court must therefore address the question of whether a tax claim which arises out of the same transactions which form the basis of Claims Court litigation is subject to that court's compulsory counterclaim rule, as the Claims Court has held, *Adams v. United States,* 358 F.2d 986 (Ct. Cl. 1966); *T. F. Scholes, Inc. v. United States,* 357 F.2d 963 (Ct. Cl. 1966), or are not so subject, as the Court of Appeals for the Eleventh Circuit has held in the opinion below.

In like manner, this Court should address the parameters of § 3505 liability for computer payroll operations and IRS regulations concerning ordinary working capital loans, where, as here, the facts are undisputed and a summary judgment motion nonetheless has been denied. The questions presented herein have considerable ramifications, for the effect of the decision below is to leave the Claims Court compulsory counterclaim rule uncertain and unsettled and create uncertainty as to the meaning of the tax statute and implementing regulations, thus frustrating the intended effect of Rule 56 of the Federal Rules of Civil Procedure. This brings about needless and expensive litigation, and imposes an unnecessary burden on the judicial system.

1. The damages and liabilities of MNB during the third and fourth quarters of 1977 were at issue before the United States Claims Court. Had Dri-Mix paid these taxes by funds advanced by MNB or checks drawn on overdrafted accounts at MNB, the amounts thereof would have been included as damages recovered in Congressional Reference No. 1-80, as were all other loan and overdraft amounts. The fact that the government postponed asserting its tax claim herein until after the record in that action was closed makes such tax claim no less an element of the government's liabilities to MNB. Moreover, the Claims Court had before it all parties needed to adjudicate any disputed factual issues.

Rule 13(a) of the Rules of the United States Claims Court specifically provides for the filing of compulsory counterclaims:

> The answer shall state as a counterclaim any claim which, at the time of serving the answer, the defendant has against any plaintiff, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim . . . .

Rule 13(a) is in all material respects identical to Rule 13(a) of the Federal Rules of Civil Procedure with respect to compulsory counterclaims.[4] There can be no question

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[4]Rule 13(a) replaced, in part, Rule 11(b) of the former Rules of the Court of Claims, Appendix D, Procedure in Congressional Reference Cases. Rule 11(b), in effect at the time the petition in Congressional Reference No. 1-80 was filed, provided that the rules with respect to compulsory counterclaims was applicable in Congressional Reference cases "in order to determine the positions of offsets." Rule 13(a) was effective pursuant to Rule 1 on October 1, 1982 as to existing cases then pending before the Claims Court, including Congressional Reference No. 1-80.

that any recovery by the government in this case would constitute an offset to MNB's entitlement to recovery. MNB was adjudged to be entitled to recover *all* of its damages in the Congressional Reference case. Stated conversely, the government was adjudged to be the party which should bear *all* the losses occasioned by its handling of V-loans I and II.

Until V-loan I collapsed, Dri-Mix had *never* been delinquent in its payment of withholding taxes, and all taxes now sought to be recovered from MNB are attributable solely to the time period after V-loan I. By refraining from making its claim in the proper forum of the Claims Court, the government seeks to avoid the determination judicially made that it should bear all of these losses for its own malfeasance, to deny the Claims Court the determination of the position of offsets and to assign a loss to MNB which rightfully should be borne by the government.

A compulsory counterclaim is one which arises from the same transaction or occurrence as is made the basis of the previous claim.[5] The factors determinative of whether the counterclaim is compulsory are whether the two claims are inextricably intertwined so that success

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[5]In determining whether a counterclaim is compulsory because it arises out of the transaction or occurrence which is the subject matter of another claim, the test to be applied is the "logical relationship" test, which is one which depends not so much on the immediacy of the connection with the previous claim as upon its logical relation to that claim. *Board of Ed. of Evanston Jr. High School Dist. No. 202, Cook County, Ill. v. Admiral Heating and Ventilation*, 511 F.Supp. 343 (N.D. Ill. 1981); *Adolph Coors Co. v. Davenport Mach. & Foundry Co.*, 89 F.R.D. 148 (D. Colo. 1981).

on one renders the other moot; whether there results a multiplicity of litigation; and whether it is fair to preclude the other claim for failure to plead it in the original action. *Meinrath v. Singer Co.,* 87 F.R.D. 422 (S.D. N.Y. 1980). Other factors include mutuality of proof and whether res judicata will bar the subsequent or later claim. *Sue & Sam Mfg. Co. v. B-L-S Const. Co.,* 538 F.2d 1048 (4th Cir. 1976); *Pipelines Local Union No. 798, Tulsa, Okla. v. Ellerd,* 503 F.2d 1193 (10th Cir. 1974). However, a precise identity of issues and evidence between the two claims is not required, nor is an absolute identity of facts and issues. *Cypress Corp. v. Whitman,* 93 F.R.D. 598 (S.D. N.Y 1982); *Meinrath v. Singer Co., supra.* Clearly, the facts of this matter satisfy these tests.

It is well settled that the failure to assert a compulsory counterclaim constitutes a waiver of and bar to that claim in a subsequent proceeding. *Cleckner v. Republic Van & Storage Co., Inc.,* 556 F.2d 766 (5th Cir. 1977); *Baker v. Gold Seal Liquors, Inc.,* 417 U.S. 467, 94 S.Ct. 2504, 41 L.Ed.2d 243 (1974). This Court should declare, therefore, that the government is, accordingly, barred from maintaining this action by its failure to assert it as a compulsory counterclaim in Congressional Reference No. 1-80.

2. In support of its claim under § 3505(a) concerning liability for direct payment of wages, the government relies on the fact that MNB, through its payroll service department, prepared the physical checks which Dri-Mix then distributed to its employees. However, the regulations of the Internal Revenue Service, 26 C.F.R. § 31.3505-1(c)(2), Example (2) state as follows:

> N, a construction company, maintains a payroll account with the O bank in which N deposits its own funds. Pursuant to an automated payroll service agreement between N and O, O prepared payroll checks and earning statements for each of N's employees reflecting the net paid due each such employee. These checks are delivered to N for signature. After the checks are signed, O distributes them directly to N's employees on the regularly scheduled payday. O, acting only in the capacity of a disbursing agent of N's funds, would incur no liability under § 3505 with respect to these payroll distributions.

It is admitted that Dri-Mix supplied the raw data information to MNB's payroll service department, that the payroll service department computed the employees' earnings statements and checks, and that the checks were forwarded to Dri-Mix for distribution to its employees. These are the only actions taken by MNB with respect to any alleged direct payment of Dri-Mix's employees, and these actions are specifically stated by the Internal Revenue Service regulations to fall outside the scope of § 3505(a).[6] Accordingly, the courts below should have effected the policy of the regulations and Rule 56 by entering judgment on the undisputed facts.

3. It has been stipulated by the parties that all of the loans and advances to Dri-Mix during the third and fourth quarters of 1977 were ordinary working capital loans. The regulations of the Internal Revenue Service, 26 C.F.R. § 31.3505-1(b)(3), state as to such ordinary working capital loans:

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[6]As stated in *United States v. North Side Deposit Bank*, 569 F.Supp. 948 (D. Pa. 1983), holding that no § 3505(a) liability existed under similar circumstances, such a "link . . . is to attenuated to amount to direct payment as defined under § 3505 (a)." 569 F.Supp. at 962.

> *Ordinary working capital loan.* The provisions of Section 3505(b) do not apply in the case of an ordinary working capital loan made to an employer, even though the person supplying the funds knows that part of the funds advanced may be used to make wage payments in the ordinary course of business. Generally, an ordinary working capital loan is a loan which is made to enable the borrower to meet current obligations as they arise. *The person supplying the funds is not obligated to determine the specific use of an ordinary working capital loan or the ability of the employer to pay the amounts of tax required by Subtitle C* of the Code to be deducted and withheld. [Emphasis added].

This regulation finds its origin in the Legislative History to Pub.L. 89-719 which enacted § 3505. Therein, at 3 U.S.Cong. & Admin. News 66, p. 3744, the Legislative History provides:

> The bill provides that if two conditions exist, a lender, etc., is to be personally liable for any unpaid withholding taxes even though he does not himself directly pay the wages or employees of the employer (the borrower). First, for this to be true, the lender, etc., must know that the funds he advances are to be used specifically for the payment of wages. *This does not include an ordinary working capital loan even though the lender, etc., knows that part of the funds may be used to make wage payments in the ordinary course of business.* Second, for the provisions to apply, the supplier of the funds must have actual notice or knowledge that the employer does not intend to, or will not be able to, make timely payment or deposit of the withholding taxes. The burden of establishing actual notice or knowledge in such cases is on the government. [Emphasis added.]

There are no triable issues on this point herein since the funds supplied by MNB were ordinary working capital

loans, and the government has so stipulated. Further, it is uncontroverted that the funds were actually used only for Dri-Mix's working capital needs, including payroll, as is set forth by the government in the V-loan I and II loan agreements. Under these circumstances, the exclusion set forth above as the first condition operates to preclude attachment of liability under § 3505(b).

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## CONCLUSION

The cross-petition for writ of certiorari should be granted.

Respectfully submitted,

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April 1986

## APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

Nos. 84-7513, 84-7522

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLANT,
CROSS-APPELLEE,

v.

MERCHANTS NATIONAL BANK OF MOBILE,
DEFENDANT-APPELLEE,
CROSS-APPELLANT.

Decided: Oct. 7, 1985

Before RONEY and FAY, Circuit Judges, and DUMBAULD*, District Judge.

PER CURIAM:

The United States appeals the district court's order granting summary judgment in favor of the defendant, Merchants National Bank of Mobile (MNB). MNB cross-appeals the district court's order denying its first motion for summary judgment. For the reasons which follow, we affirm the district court in all respects.

### I. BACKGROUND

On March 18, 1983, the United States brought this action alleging that under 26 U.S.C. § 3505(a) & (b), MNB

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*Honorable Edward Dumbauld, U.S. District Judge for the Western District of Pennsylvania, sitting by designation.

was liable to it for unpaid federal income and social security taxes owed by Dri-Mix Products, Inc. (Dri-Mix). The complaint alleged that beginning in January, 1977, MNB paid wages directly to employees of Dri-Mix and supplied funds to Dri-Mix for the specific purpose of paying net wages to employees with notice or knowledge that Dri-Mix did not intend to, or would not be able to, make timely payment or deposit of the amounts of taxes required by law to be deducted and withheld. *See id.*

MNB answered, and both parties subsequently filed motions for summary judgment. These motions were denied by the district court on May 16, 1984. MNB thereafter sought and was granted leave to amend its answer to assert the affirmative defense that the United States failed to give MNB notice of the assessments against Dri-Mix within the 60-day period required by 26 U.S.C. § 6303 (a). Defendant filed its second motion for summary judgment, contending that the United States' failure to give MNB the § 6303(a) notice precluded the United States from bringing suit. The district court, relying on *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), agreed with MNB and dismissed the complaint with prejudice. The United States filed a timely notice of appeal, and MNB cross-appealed the district court's order denying its first motion for summary judgment.

## II. THE NOTICE REQUIREMENT

The United States argues on appeal that it was not required to give MNB the § 6303(a) notice of assessment as a prerequisite to suit against MNB for Dri-Mix's unpaid employment taxes. The Seventh Circuit, in *Associates Commercial Corp.*, rejected an identical argument.

In that case, the court noted that § 6303(a) "requires that notice of an assessment of unpaid taxes must be provided to 'each person liable for the unpaid tax' within sixty days after the assessment was made, unless otherwise provided by the Internal Revenue Code." 721 F.2d at 1098. Since § 3505 did not exempt § 6303(a) lenders potentially liable, and since no other exemption could be found, the court concluded that the lender, a "person liable for the unpaid tax" within the meaning of § 6303(a), was entitled to notice of assessment of the unpaid tax. 721 F.2d at 1098. The court held that the government's failure to provide the statutorily required notice barred its suit. *Id.* We agree with the Seventh Circuit's reading of the applicable statutory provisions and hold that the United States' failure to provide MNB with the § 6303(a) notice bars the present suit against MNB.[1]

## III. MNB'S CROSS-APPEAL

MNB appeals the district court's denial of its first motion for summary judgment. Counsel for MNB all but conceded at oral argument, however, that this appeal is without merit. We agree and affirm the district court.

> Summary judgment is appropriate only when the moving party has sustained its burden of proving that there exists no genuine issue of material fact after

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[1]The United States also argues that even if § 6303(a) requires notice to third-parties, such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged § 3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however ignores the fact that third-party derivative liability of the sort set forth in § 3505 is a creature of statutory, not common, law. This argument is therefore untenable.

> reviewing all the evidence in the light most favorable to the party opposing the motion. [citations omitted]. The district court's order granting a summary judgment motion is not a discretionary decision and thus will be independently reviewed by the appellate court.

*Wong v. Bailey*, 752 F.2d 619, 620-21 (11th Cir. 1985). The decision to *deny* a summary judgment, however, is discretionary with a trial court, and we will reverse only for an abuse of discretion. *See Johnson v. Bryant*, 671 F.2d 1276, 1279 (11th Cir. 1982); *see also Marcus v. St. Paul Fire & Marine Ins. Co.*, 651 F.2d 379, 382 (5th Cir. Unit B 1981) (a district court may, in a proper case, deny "harsh remedy" of summary judgment even if the motion is justifiable under Fed.R.Civ.P. 56, if the court, in "the sound exercise of judicial discretion," decides "to give the parties an opportunity to fully develop the case."). After carefully reviewing the record with these principles in mind, we conclude that the district court did not err in denying MNB's first motion for summary judgment.

AFFIRMED.

## APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ALABAMA SOUTHERN DIVISION

Civil Action No. 83-0266-T

UNITED STATES OF AMERICA,

Plaintiff,

v.

MERCHANTS NATIONAL BANK OF MOBILE,

Defendant.

Filed: May 31, 1984

### FINDINGS OF FACT AND CONCLUSIONS OF LAW

On May 30, 1984, the defendant, Merchants National Bank of Mobile, filed with the court, Second Motion for Summary Judgment for Defendant. The Court, having considered said motion and having carefully examined the record before the Court, is of the opinion that defendant's second motion for summary judgment is due to be granted and, therefore, enters the following findings of fact and conclusions of law.

### FINDINGS OF FACT

1. Plaintiff is the United States of America acting by and through its attorney, J. B. Sessions, III, United States Attorney for the Southern District of Alabama.

2. Defendant is the Merchants National Bank of Mobile (hereafter MNB), a national banking association

with its principal offices in the County of Mobile, State of Alabama, located at 106 St. Francis Street.

3. The Court has jurisdiction over the action pursuant to §§ 1340, 1345 and 1346 of Title 28, United States Code, and § 7402 of the Internal Revenue Code of 1954, Title 26, United States Code.

4. A delegate of the Secretary of the Treasury made assessments for unpaid taxes against Dri-Mix Products, Inc. (hereafter Dri-Mix). The dates of the assessments made against Dri-Mix were November 9, 1977, for the Form 941 unpaid federal employment tax liabilities for the third quarter of 1977, and May 15, 1978, for the Form 941 unpaid federal employment tax liabilities for the fourth quarter of 1977. Notices of the assessments were given to and demands for payment were made on Dri-Mix on those same dates.

5. Plaintiff has alleged that MNB directly paid wages for the year 1977 and during the first quarter of 1978 to employees of Dri-Mix or to an agent on behalf of said employees, and failed to withhold the applicable taxes, thus giving rise to liability under the Internal Revenue Code of 1954, Title 26, § 3505(a).

6. Plaintiff has also alleged that MNB supplied funds to or for the account of Dri-Mix for the specific purpose of paying net wages of employees for the year 1977 and during the first quarter of 1978 with notice or knowledge within the meaning of § 6323(i)(1) of the Internal Revenue Code that Dri-Mix did not intend to, or would not be able to, make timely payment or deposit of the amounts of tax required by federal law to be deducted and withheld from the wages of the employees, thus giving

rise to liability under § 3505(b) of the Internal Revenue Code.

7. The Court finds that at no time did plaintiff give, nor [did] MNB receive, any written notice of the assessments against Dri-Mix and MNB specifically did not receive any such notice within sixty (60) days of the assessments made on November 9, 1977, and May 15, 1978. (Affidavit of Clarence C. Keller attached hereto)

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## CONCLUSIONS OF LAW

1. Summary judgment is due to be granted to MNB with respect to any alleged liability under § 3505(a) for direct payment of wages, or under § 3505(b) for supplying funds to be used for the specific purpose of paying wages with knowledge that the employer did not intend to, or was unable to, make timely deposit of withholding taxes because of plaintiff's failure to give notice of the assessments against Dri-Mix to MNB as required by § 6303(a) of the Internal Revenue Code, 26 U.S.C.A. § 6303(a).

2. Section 6303(a) provides as follows:

> *General Rule*—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within sixty (60) days, after the making of an assessment of a tax pursuant to section 6203 give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

3. Until quite recently, there seemed to be no clear rule as to the applicability of § 6303(a) to any alleged liability under § 3505. However, the Seventh Circuit has recently decided this issue in the case of *United States v. Associates Commercial Corporation*, 721 F.2d 1094 (7th Cir. 1983). Therein, the Court found that application of § 6303(a)'s notice provisions gave effect to the intent of Congress to narrow the scope of § 3505 liability. Therein, the Court stated:

> [F]ailure to apply Section 6303(a)'s notice provisions would increase the likelihood of imposing derivative tax liability on lenders that Section 3505(b) was designed to protect and whose ability to defend against liability would of course be diminished absent prompt notice of the government's potential claim. [Citation omitted]. Thus instead of defeating Congress' intent, as the government argues, applying Section 6303(a)'s notice provisions to lenders allegedly subject to Section 3505(b) liability gives effect to that intent.[1]

4. The Seventh Circuit relied on the rationale of the Ninth Circuit in *United States v. Dixie Line Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), which recognized that § 6303(a) applied to § 3505 cases, but did not reach a conclusion as to "the consequences that flow from that fact." 594 F.2d at 1313.

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[1]The Government correctly argues that there is no general requirement that a potential defendant receive notice that a suit may be instituted against it. However, the care with which Congress developed the very narrow remedy provided in Section 3505(b) and the absence of any language in that statute to override Section 6303(a)'s notice requirement convinced us that there is a particular requirement of notice of assessment here, thus alerting a lender to a possible civil action.

5. The Seventh Circuit answered that question in rejecting the Government's contentions that failure to give notice would not preclude a civil action alleging § 3505 liability, stating:

> Section 6303(a) itself does not indicate that the right to notice is dependent on which tax collection option the government uses. [Citation omitted]. Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, *see MacAtee, Inc. v. United States*, 214 F.2d 717, 719 (5th Cir. 1954), and this rationale applies regardless of which collection mechanism is used.

721 F.2d at 1100. Thus, § 6303(a) applies to cases alleging § 3505 liability, whether for direct payment under § 3505(a) or indirect payment under § 3505(b), and the failure of plaintiff to give the required notices of assessment to MNB precludes this civil action.

6. Based on the foregoing findings of fact and conclusions of law, the Court is of the opinion that there exists no genuine issue of material fact.

7. A Judgment will be entered for the defendant in accordance herewith.

DONE this the 31st day of May 1984.

/s/ Daniel H. Thomas
UNITED STATES
DISTRICT JUDGE

## APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

Nos. 84-7513, 84-7522

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D. C. Docket No. 83-0266

UNITED STATES OF AMERICA,

Plaintiff-Appellant,
Cross-Appellee,

v.

MERCHANTS NATION BANK OF MOBILE,

Defendant-Appellee,
Cross-Appellant.

Appeals from the United States District Court for the Southern District of Alabama

Before RONEY and FAY, Circuit Judges, and DUMBAULD*, District Judge.

JUDGMENT

These causes came on to be heard on the transcript of the record from the United States District Court for the Southern District of Alabama, and were argued by counsel;

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgments of the said District Court in these causes be and the same are hereby, AFFIRMED;

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*Honorable Edward Dumbauld, U.S. District Judge for the Western District of Pennsylvania, sitting by designation.

It is further ordered that plaintiff-appellant/cross-appellee pay to defendant-appellee/cross-appellant, the costs on appeal to be taxed by the Clerk of this Court.

Entered: October 7, 1985
For the Court: Spencer D. Mercer, Clerk

ISSUED AS MANDATE: NOV. 25, 1985

## APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

Civil Action No. 83-0266-T

UNITED STATES OF AMERICA,

Plaintiff,

v.

MERCHANTS NATIONAL BANK OF MOBILE,

Defendant.

JUDGMENT

Pursuant to the Findings of Fact and Conclusions of Law this day entered, it is hereby ORDERED, ADJUDGED and DECREED that the Second Motion for Summary Judgment filed by the defendant, The Merchants National Bank of Mobile, is GRANTED.

It is FURTHER ORDERED, ADJUDGED and DECREED that this action is hereby DISMISSED WITH PREJUDICE.

Costs taxed against the plaintiff.

DONE this the 31st day of May 1984.

Daniel H. Thomas
UNITED STATES DISTRICT
JUDGE

## APPENDIX E

Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the years at issue:

SEC. 3505. LIABILITY OF THIRD PARTIES PAYING OR PROVIDING FOR WAGES.

(a) *Direct Payment By Third Parties.*—For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to any employee or group of employees, pays wages directly to such an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

(b) *Personal Liability Where Funds Are Supplied.*—If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of taxes required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or

other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

(c) *Effect of Payment.*—Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer.

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